A1310 - 1.12 F

American Council for Capital Formation
Center for Policy Research

December 1990

SPECIAL REPORT

The Tax Treatment of Expenditures On Anti-Pollution Equipment by Major U.S. Competitors

To explore the cost of the Clean Air Act Amendments of 1990, the ACCF Center for Policy Research sponsored a symposium on "Environmental Policy and the Cost of Capital" on June 11 and subsequently published a monograph on the symposium proceedings. By publishing this Special Report, *the Center continues to raise the question: How can sound and effective environmental regulation be achieved at the least cost in terms of U.S. economic growth? This* Special Report, *which focuses on how other nations' tax policies encourage the purchase of pollution-control equipment, may be helpful to policymakers as they debate proposals to increase U.S. competitiveness in world markets while achieving environmental goals.*

The benefits to our environment that will be realized as a result of the recent passage of the Clean Air Act Amendments of 1990 will be achieved at considerable costs for both business and consumers. Experts estimate that these costs will add $30 billion (in inflation-adjusted dollars) to the $90 billion that is spent annually to comply with environmental regulations. These additional pollution-control outlays will have a negative impact on the growth of U.S. gross national product and business investment and on the cost of capital, particularly in light of the fact that these outlays must be depreciated at the same rate as other equipment.

According to a recent study by the Law Library of Congress, as pollution has become more and more of a global concern, the number of industrialized countries that require manufacturers to acquire pollution-control devices has grown steadily.[1] To encourage or facilitate compliance with these laws, a number of governments have included incentives in their tax legislation. Accelerated depreciation is the most common type of tax concession that has been granted to certain types of businesses that acquire anti-pollution equipment. Canada, France, Germany, India, Japan, Singapore, and Taiwan all currently have or in the recent past have had special rates for the writing off of equipment and properties purchased for the purpose of preventing pollution or damage to the environment. Eligibility to claim the benefits of these accelerated rates is not dependent on the equipment being specifically mandated but is often contingent on government certification of the particular type of equipment. Because the various countries' special rates established different rules for the amount of depreciation that can be taken in an acquisition year, any country-by-country comparison must be made with considerable caution. Nevertheless, it appears that most of the countries that offer special rates for the depreciation of anti-pollution devices allow at least 80 percent of the acquisition cost to be written off in no more than three years.

U.S. firms, in contrast, must generally recover the cost of pollution-control investments over a significantly longer period. In the United States, pollution-control modifications to plants put in operation after 1975 or pollution-control outlays for a new facility must be depreciated using the applicable schedule for the equipment or structure being modified or constructed. Thus, for example, a U.S. firm recovers only 56.3 percent of its cost after three years under the Modified Accelerated Cost Recovery System (28.2 percent if the firm pays the alternative minimum tax) for pollution-control equipment assigned a seven-year recovery period.

Instead of giving tax concessions to industries, the governments of a number of major industrialized countries award grants to help businesses acquire pollution-control equipment. The United Kingdom is the preeminent example of a nation that prefers to give such a direct type of subsidy.

The table that follows compares the tax treatment of anti-pollution equipment by several of our major industrial competitors.

[1] Stephen F. Clarke, "The Tax Treatment of Expenditures on Anti-Pollution Equipment in Selected Foreign Countries," American-British Law Division, Law Library of Congress, February 1990.

Country	Type of Asset	Tax Treatment
Canada	Equipment used to prevent, reduce, or eliminate air or water pollution.	• Assets acquired to modify equipment or buildings owned or operated prior to 1974 can be depreciated over a 3-year period; 25% can be written off the first year, with the balance written off over the remaining 2 years. • Assets are exempt from Canada's 13.5% federal excise tax (FET); they will, however, apparently be subject to the 7% VAT that is expected to replace the FET in 1991.
Japan	Equipment used to prevent, reduce, or eliminate air, water, or noise pollution.	• Equipment used for pollution control is depreciated over a 7-year period using the straight-line method with an additional first-year write-off of 21% . Thus equipment with a 7-year life receives a depreciation allowance of approximately 35% in the first year. • Structures used in pollution control (e.g., chimneys, towers, etc.) are depreciated over a period of 10 to 30 years; they also receive an additional first-year write-off of 21% . • Eighty percent of capital gains on sales of property in pollution-control areas can be deferred if proceeds are reinvested in non-controlled areas. • Purchases of pollution-control equipment not manufactured in Japan are exempt from certain duties.
West Germany	Equipment that serves more than 70% for the purpose of reducing air, water, or noise pollution.	• Assets acquired between 1975 and 1990 receive a 60% deduction in the first year, with the balance written off at 10% per year; assets acquired prior to 1975 receive accelerated depreciation.
Singapore	Equipment used to prevent, control, or reduce air or water pollution.	• Assets acquired between 1975 and 1987 can be depreciated over 3 years at a rate of 33.3% per year.
Mexico	Equipment used to control air, water, or noise pollution.	• Assets of Mexican-owned corporations receive a tax credit equal to 24% of the cost of the asset. • Mexican-based firms that manufacture pollution-control equipment receive a tax credit for the wages of new employees for the first 2 years of their employment. The credit is 20% of the prevailing minimum wage for each full-time employee.
France	1. Equipment used to purify industrial water or air or to remove odors. 2. Equipment used in collecting and processing waste that saves energy and raw materials and indirectly helps pollution efforts.	1. Assets receive a 50% deduction in the first year. 2. Assets receive accelerated declining balance depreciation.
Taiwan	Equipment used to prevent air or water pollution.	• Assets can be depreciated over two years.
India	Equipment used to reduce air or water pollution.	• Assets receive a 30% deduction in the first year and can be fully depreciated over the subsequent 3- to 4-year period.

Source: Stephen F. Clarke, "The Tax Treatment of Expenditures on Anti-Pollution Equipment in Selected Foreign Countries," American-British Law Division, Law Library of Congress, February 1990, LL 90-10. Table prepared by the American Council for Capital Formation Center for Policy Research, December 1990.

The ACCF Center for Policy Research is the education and research affiliate of the American Council for Capital Formation. Its mandate is to promote an understanding by the public of the importance of capital formation to the economy. For more information or to receive additional copies of this *Special Report*, please contact: ACCF Center for Policy Research, 1850 K Street, N.W., Suite 400, Washington, D.C. 20006, (202) 293-5811.